

**Management Advisory Report:
The Internal Revenue Service Has Made
Progress to Address Tax Law Complexity
and to Control New Tax Law Implementation**

September 2002

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 25, 2002

MEMORANDUM FOR COMMISSIONER ROSSOTTI

FROM: *Michael R. Phillips*
Michael R. Phillips
Acting Deputy Inspector General for Audit

SUBJECT: Final Management Advisory Report - The Internal Revenue Service Has Made Progress to Address Tax Law Complexity and to Control New Tax Law Implementation (Audit # 200240064)

This management advisory report presents the results of our study to evaluate the actions that the Internal Revenue Service (IRS) has taken to address tax law complexity and to determine whether the IRS has installed controls to ensure that new tax laws are implemented timely.

The IRS faces the formidable task of being responsible for administering our country's tax laws. Two of the barriers to the IRS meeting this responsibility are the complexity of the tax laws and the frequent changes being made to the tax laws. It is clear that the IRS has recognized the importance and sensitivity of tax law complexity, has elevated the concerns to the highest levels within the IRS, and has invested significant resources throughout the organization to address the problems. We also concluded that the IRS' Legislative Implementation Tracking System is designed to be an effective control to monitor the implementation of new tax legislation. The system is designed to provide timely, useful information to management and quickly elevate any delays in implementing new tax laws to a level of management high enough to address the problem.

Because this is a positive report and we did not make any specific recommendations, comments from the IRS were not required.

Copies of this report are also being sent to the IRS managers affected by the report. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

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Address Tax Law Complexity and to Control New Tax Law Implementation**

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Background

The Internal Revenue Service (IRS) faces the formidable task of being responsible for administering our country's tax laws. Two of the major barriers to the IRS meeting this responsibility are the complexity of the tax laws and the frequent changes being made to the tax laws.

The objectives of this study were to evaluate the actions that the IRS has taken to address tax law complexity and to determine whether the IRS has installed controls to ensure that new tax laws are implemented timely. We conducted the study at the IRS Headquarters Office in Washington, D.C., during February 2002 in the Office of Legislative Affairs and the Office of Tax Administration Coordination (OTAC). Our report is primarily based on an evaluation of internal controls and actions taken by the IRS because our results indicated that the IRS was highly involved in addressing tax law complexity and had established controls designed to ensure implementation of new tax laws. We performed limited tests of transactions.

The study was conducted in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*. Detailed information on our study objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The Internal Revenue Service Has Taken Actions to Address Tax Law Complexity

Tax law complexity is one of the major management challenges facing the IRS. It is an issue of interest to the IRS, the Congress, and taxpayers in general. Each has a different perspective, but all agree that the current tax laws are difficult for taxpayers to understand and hard for the IRS to implement. For example, one of the most frequently expressed concerns is having five filing statuses and being able to differentiate among them. Also, the Earned Income Tax Credit (EITC) is complex because of the various tests required to qualify for the dependent credit. Many taxpayers find it difficult to distinguish between the definitions of terms such as "qualifying child" for EITC purposes and "qualifying child" for dependent purposes.

Both the IRS and the Taxpayer Advocate make an annual report to the Congress. During our study we evaluated the following reports to the Congress that specifically related to tax law complexity:

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- Annual Report from the Commissioner of the IRS on Tax Law Complexity, dated June 5, 2000.
- Joint Committee on Taxation Study of the Overall State of the Federal Tax System and Recommendations for the Simplification, issued in April 2001.
- National Taxpayer Advocate Fiscal Year 2001 Annual Report to Congress, dated December 31, 2001.

Our analysis of the annual reports clearly shows that the IRS is investing significant resources into the issues surrounding tax law complexity. In the reports, the IRS identifies the causes of tax law complexity, the specific issues that cause problems, and the steps that can be taken to simplify the tax law. For example, in the previously mentioned concern about the EITC, the IRS recommended adopting one definition of the relationship for dependents and qualifying individuals for tax credits, including the EITC.

Similarly, the Taxpayer Advocate's report addresses the issues of concern to taxpayers. For example, taxpayers have a difficult time determining if they are eligible for the EITC. Despite improvements by the IRS, the Taxpayer Advocate is concerned that some taxpayers will continue to experience difficulties. Both perspectives raise similar concerns and both perspectives recognize that the Congress must act to make any significant strides to simplify tax laws and tax law administration.

In summary, it is clear that the IRS has recognized the importance and sensitivity of tax law complexity, has elevated the concerns to the highest levels within the IRS, and has invested significant resources throughout the organization to address the problems. It is also clear that the problems associated with tax law complexity cannot be solved by the IRS alone. However, the IRS continues to provide annual reports on tax law complexity and maintains an open dialog with both the Congress and taxpayers through the Taxpayer Advocate to minimize the adverse impact of complex tax laws.

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The Internal Revenue Service Has Implemented Controls to Ensure Timely Implementation of New Tax Laws

One of the factors that has had a significant impact on the complexity of tax laws is the frequency and scope of new tax legislation. Recently, the IRS has been faced with sweeping tax law changes. It is the responsibility of the Congress to make new tax laws and it is the responsibility of the IRS to implement those new tax laws. However, the difficulties of administering tax laws increases with the volume and frequency of tax law changes.

Prior to new tax legislation being passed, the IRS Office of Legislative Affairs coordinates comments on pending legislation, distributes legislative materials, and coordinates communications with the Congress. When new tax laws are passed, the IRS is challenged not only to implement the new legislation but also to perform related activities such as developing forms associated with the laws and issuing guidance to clearly explain the laws.

After the laws have been passed, the OTAC establishes controls over the implementation of each new piece of legislation. The OTAC has developed the Legislative Implementation Tracking System (LITS) as the primary control to monitor new tax laws. The LITS was designed to help ensure that new tax laws are successfully implemented on a timely basis. The following is a list of some of the information that is found on the LITS for each tax law pending implementation:

- Executive owner of the provision.
- Implementation target dates.
- Actions planned.
- Actions completed.
- Implementation status.

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A simple green, yellow, red color-coding system is used to show the implementation status of each new tax law.

- Green – All actions for the provision are on schedule and within budget. Risks are non-existent or minimal.
- Yellow – One or more actions is causing a delay; however, the situation is manageable and resolvable. Risks are identified, but so are mitigating strategies.
- Red – The provision is in danger of not being implemented timely. Without immediate attention, the provision cannot move forward. Risks are either not identified or are identified without any mitigating strategies.

Any provision in a “red” status that cannot be promptly resolved by the provision owner should be elevated to the division commissioner/functional chief.

Anyone with access to the IRS Intranet can review LITS information, but update capabilities require a password. The LITS tracks the implementation of tax laws through three regularly generated reports – all open provisions, provisions with overdue action items, and provisions with action items due within 30 days.

We did not trace all tax law changes to the LITS. Instead, we evaluated the system by reviewing the status of the 73 provisions shown for the Wage and Investment Division as of February 14, 2002. Overall, we believe that the LITS is an effective control to monitor the implementation of new tax legislation because the system is designed to provide timely, useful information to management. If there are any delays in implementing new tax laws, the LITS should quickly elevate the problems to a level of management high enough to address the problem.

Detailed Objectives, Scope, and Methodology

The objectives of this study were to evaluate the actions that the Internal Revenue Service (IRS) has taken to address tax law complexity and to determine whether the IRS has installed controls to ensure that new tax laws are implemented timely.

- I. To evaluate the actions that the IRS has taken to address tax law complexity, we:
 - A. Interviewed representatives from the Office of Legislative Affairs and the Office of Tax Administration Coordination.
 - B. Reviewed the following documents:
 - 1. Annual Report from the Commissioner of the IRS on Tax Law Complexity, dated June 5, 2000.
 - 2. National Taxpayer Advocate Fiscal Year 2001 Annual Report to Congress, dated December 31, 2001.
 - 3. Joint Committee on Taxation Study of the Overall State of the Federal Tax System and Recommendations for the Simplification, issued in April 2001.
- II. To determine whether the IRS has installed controls to ensure that new tax laws are implemented timely, we:
 - A. Interviewed representatives from the Office of Legislative Affairs and the Office of Tax Administration Coordination.
 - B. Reviewed the following documents:
 - 1. The IRS Restructuring and Reform Act of 1998 (RRA 98).¹
 - 2. The Economic Growth and Tax Relief Reconciliation Act of 2001.²

¹ Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).

Major Contributors to This Report

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Appendix III

Report Distribution List

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